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October 13, 2005

**RE: Docket No. W-01445A-04-0650, *In the Matter of the Application of Arizona Water Company, an Arizona Corporation, for Adjustments to its Rates and Charges for Utility Service Furnished by its Western Group and for Certain Related Approvals***

Dear Chairman and Commissioners:

Frito-Lay North America, Inc. ("Frito-Lay") hereby submits this comment letter for inclusion in the above-referenced docket. Frito-Lay does not oppose the application for a rate increase filed by Arizona Water Company ("AWC"). We do, however, take strong exception with the inverted rate design proposed by the Arizona Corporation Commission Utilities' Division Staff ("Staff"). This proposed rate design significantly increases costs to Frito-Lay, as well as several other high volume users, and actually decreases costs to the vast majority of AWC's customers. This rate design unfairly and disproportionately shifts costs to high volume users, particularly Frito-Lay and our neighbor in Casa Grande, Ross-Abbott Laboratories. Frito-Lay has not participated in these proceedings to date as we were unaware that the application for a rate increase had been filed by AWC. Frito-Lay became aware of this action in late August, 2005, when we made a basic inquiry to AWC concerning future water availability and rates.

Frito-Lay is submitting our concerns with the rate design proposed by Staff, and adopted by the Administrative Law Judge's October 4, 2005 Recommended Opinion and Order ("ROO"), for consideration by the Commission at the Special Open Meeting scheduled for October 18 and 19, 2005.

**I. Background**

Frito-Lay is a Delaware corporation authorized to do business in Arizona. Frito-Lay has been operating its food processing facility in Casa Grande for over 23 years. We currently employ over 550 Arizonans, with an annual payroll of \$15 million per year. The Frito-Lay facility provides a high wage base, with the average salary of \$35,000 per year. Furthermore, Frito-Lay invests thousands of dollars per year in the ongoing development of its employees.

Frito-Lay's investment in its Casa Grande facility is substantial, including over \$100,000,000 in improvements and equipment investment. Frito-Lay also contributes over \$1 million per year in property and sales and use taxes to the Arizona economy. The Casa Grande facility produces approximately 70 to 80 million pounds of product per year, and competes with other Frito-Lay facilities in the southwestern United States for production volume based on the lowest cost-per-pound of product produced.

**II. Frito-Lay Strongly Objects to Staff's Inverted Rate Design**

Frito-Lay is not opposed to AWC's proposed rate increase. We recognize that AWC has not had a rate increase in many years and that AWC must install additional treatment for control of arsenic and other constituents, at considerable cost. However, Frito-Lay strongly opposes a rate design that subsidizes other customers while loading additional unfair cost upon Frito-Lay. Frito-Lay believes that the cost for supplying water should be borne proportionately by all customers. Staff's proposed inverted rate design poses serious economic impacts on Frito-Lay's business and day-to-day operations. In an extremely competitive market for producing its products, increased rates that are arbitrarily imposed on non-discretionary water usage will impact the Frito-Lay Casa Grande facility's ability to compete and to expand.

**A. Staff's Inverted Rate Design Does Not Promote Conservation**

The basis for Staff's inverted rate design is purportedly to promote conservation. Frito-Lay does not have access to detailed customer usage information. However, based on the general information we have obtained, it is clear that the vast majority of AWC's customers will actually see a decrease in water cost. Based on 2003 data, there were approximately 14,200 customers in Casa Grande, of the 19,400 total in AWC's Western Group. The following is a summary of the impact of Staff's inverted rate design on AWC's Casa Grande system, by meter size:

Meter Size	Number of Customers	Impact
8 inch	1	Cost increase for 1 customer
6 inch	16	Frito-Lay and Ross-Abbott cost will increase 28% and 34%, respectively)
4 inch	20	Cost increase for 1 customer
3 inch	23	Cost increase for 2 customers
2 inch	263	Cost increase for 31 customers
1 inch	622	A customer must use over 57,000 gallons/month before actual increase in cost would occur. Average usage is 31,185 gallons/month.
5/8-3/4 inch	13,276	A customer must use over 20,000 gallons/month before actual increase in cost would occur. Average usage is 10,700 gallons per month.

\* Information provided by AWC

Frito-Lay believes strongly in water conservation and has had an aggressive resource conservation program in place since 1999 – fine tuning production processes to ensure that the facility uses the minimal amount of water necessary to safely produce our food products. Since 1999, our total water usage has decreased 6%, in spite of an increase in production of 34%. Water use per pound of product produced has been reduced 30%. Had Frito-Lay not taken water conservation seriously, our water consumption would be higher by over 40,000,000 gallons this year.

Staff's proposed rate design, however, arbitrarily sets a "discretionary use" threshold for our meter size at 2 million gallons per month and ignores the substantial conservation efforts we have undertaken in recent years. Frito-Lay would have to reduce water consumption by over 80% to meet Staff's proposed break-point, regardless of our processing requirements. This simply is not possible without putting the plant out of business. Thus, the ALJ's statement that the inverted rate design sends the appropriate price signal to promote conservation is unfounded. (ALJ's ROO, page 42).

Furthermore, the rate design proposed by Staff was not based on any studies to evaluate the impact on AWC's customers. For example, Staff's witness, Mr. Carlson, misstated Frito-Lay's water usage during his testimony, citing an average monthly consumption that is approximately one-quarter of our actual usage. Additionally, Mr. Carlson was not certain whether Frito-Lay was even a part of the Casa Grande system. (Hearing Transcript, pages 1291-1292). This price increase would seriously hinder the facility's ability to expand operations, which also impacts its ability to compete.

A great deal of study must be done in order to set inverted block rates that would have the desired effect of encouraging conservation. Arbitrarily setting "discretionary use" thresholds just

above the average consumption levels for each meter class will not result in the desired effect of promoting conservation, since the vast majority of users will actually see their water costs decrease as a result of the proposed rate design. In fact, Mr. Carlson admitted during his testimony at the hearing that inverted rate designs have never resulted in customers using less water. (Hearing Transcript, page 1311). This will certainly be true with the proposed rate design.

As an example, the proposed rate design sets the threshold between the 2nd and 3rd tiers at an arbitrary usage level of 2 million gallons per month for the 6 inch meter size. The total usage for all Casa Grande system customers in the 6-inch meter class averages 44.2 million gallons per month, with an average usage of 2.76 million gallons per month for these 16 customers. However, average usage by Frito-Lay and Ross-Abbott totals approximately 42 million gallons per month. Therefore, all other customers in this class fall well below the third tier cost threshold, which has the increased unit rate. Staff's proposed rate design does not promote conservation, but instead attempts to shift the burden of increased water costs to a small group of high volume users, with an effective subsidy for other users. This rate design should be rejected by the Commission.

**B. Staff's Proposed Rate Design Does Not Promote Fairness**

The Administrative Law Judge's Recommended Opinion and Order, issued on October 4, 2005, adopts a version of Staff's inverted rate design, and authorizes a revenue increase of 1.5% for the Western Group. The increase authorized for Casa Grande is \$89,542. Frito-Lay accounts for only 4% of the 282.3 million gallons per month consumed in the Casa Grande system, but the increased costs to Frito-Lay alone will be over \$60,000 – 67% of the revenue increase authorized in Casa Grande. The combined estimated increase for Frito-Lay and Ross-Abbott is \$250,000. The balance of AWC's customers will see a cost decrease of over \$160,000, yielding the net revenue increase of \$89,542. This rate design imposes an unfair burden on the larger water meter customers to subsidize the rates for the other customers.

Furthermore, the cost to deliver water to accounts like Frito-Lay is much lower than the cost to deliver it to residential or smaller volume customers. For Frito-Lay, there is one single meter to be read and one connection to maintain. For a comparable volume of water sold to residential customers, many miles of distribution system must be maintained, and many hundreds of meters must be read each month. Additionally, large users like Frito-Lay have a demand pattern that is favorable to actual cost of service in that our demand is relatively constant throughout the day and from season to season. Thus, there is no basis to shift costs to the larger meter size customers based on cost of service.

**C. Staff's Proposed Rate Design Is Not Supported by ACC Precedent**

In a recent case decided by the ACC, *In the Matter of the Application of Rio Rico Utilities Inc. for Permanent Increases for Water and Wastewater Utility Service ("Rio Rico")*, Docket No. WS-02676A-03-0434, Decision No. 67279, the Commission ruled that the inverted rate design should encourage conservation and provide that all meter classes bear an equitable proportion of the revenue increase. Frito-Lay supports the basis for this decision, and believes that the ALJ's ROO in the current case is contrary to the *Rio Rico* decision.

In the *Rio Rico* decision, the Commission rejected the rate designs proposed by both Staff and the Residential Utility Consumer Office ("RUCO") because they did not create an equitable sharing of the rate increase. This is even more true for the current case. The Commission also rejected Staff's proposed commodity rate in the first tier because it was below the (then) current rate of \$1.27. In the current case, Staff has proposed rates well below the current commodity rate in not just the first tier, but in second tier as well.

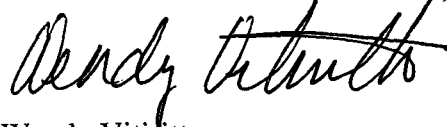
Furthermore, in the *Rio Rico* decision the Commission ruled that the 3rd tier "breakpoint" of 20,000 gallons for residential customers was too high to send the appropriate price signal to residential customers with higher usage. The Commission made this decision even though the 2nd tier (between 4,000 and 20,000 gallons) rate proposed by Staff was higher than what was at that time the current commodity rate. In the current case, the 2nd tier rate is less than the current commodity rate and residential users consuming less than 20,000 gallons per month will see a decrease in their monthly bill. Even though the "breakpoint" between the 2nd and 3rd tiers proposed by Staff in the current case is 10,000 gallons, the "effective breakpoint" before customers in the smallest meter size would see a rate increase is over 20,000 gallons.

For all of the reasons provided above, Frito-Lay requests that the Commission reject the Staff's proposed rate design. In addition to the demonstrated impacts to Frito-Lay, we believe that the rate design adopted by the ALJ poses a significant negative impact on Arizona's business community as a whole. Frito-Lay submits that the initial rate design proposed by AWC, with all users sharing a proportionate increase in costs, represents a more fair and equitable approach and comes closer to supporting the purported objective of promoting water conservation across the system. Alternatively, Frito-Lay believes the Commission should defer action on this matter to its November calendar, allowing additional opportunity for review of this important case, as well as to provide an opportunity for comment by the State's business community.

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Thank you for your consideration of Frito-Lay's concerns in this matter. If you have any questions regarding the matter raised in this letter, or require additional information from Frito-Lay, please contact the undersigned and that information will be provided to you as expeditiously as possible.

Very Sincerely,  
FRITO-LAY NORTH AMERICA, INC.

A handwritten signature in black ink, appearing to read "Wendy Vitiritto", with a stylized flourish at the end.

Wendy Vitiritto  
Manufacturing Manager  
Casa Grande Facility

cc: Jaime Chon, Frito-Lay  
Larry Perry, Frito-Lay  
Susan Chao, Esq., Frito-Lay  
Michelle De Blasi, Quarles & Brady Streich Lang LLP